

**UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF ALABAMA**

In re

Case No. 02-33243-WRS
Chapter 7

MORRIS CRAIG VEACH
LINDA HOWELL VEACH,

Debtors.

RONALD CLAYTON
LISA S. CLAYTON,

Plaintiffs,

v.

Adv. Pro. No. 03-3009-WRS

MORRIS CRAIG VEACH
LINDA HOWELL VEACH,

Defendants.

MEMORANDUM DECISION

This is an adversary proceeding to determine whether an indebtedness allegedly owed by the Debtors, Craig and Linda Veach, is excepted from discharge pursuant to 11 U.S.C. § 523(a)(2) or (4). The matter was tried on October 27, 2003. The Plaintiffs were present in person and by counsel Michael G. Strickland. The Defendants were present in person and by counsel Hugh V. Smith. The trial was concluded on October 27, 2003, and the Court requested either briefs or proposed findings and fact and conclusions of law from the parties. Both parties have complied with the Court's request. (Docs. 19, 20). The Court, having considered the evidence and the post-trial submissions made by the parties, enters judgment in favor of the Plaintiffs for the reasons set forth below. The Court will enter judgment by way of a separate document.

I. FACTS

On February 21, 2000, the Plaintiffs (the Claytons) entered into a contract with Don and Brenda Guthrie, for the purchase of 12% of the common stock of MESCO, Inc., for \$150,000.00. See Plaintiffs' Exhibit 1. At this time the Guthries owned all of the MESCO stock. The Claytons borrowed the purchase price from Colonial Bank. The Agreement further provided that \$1,500.00 per month was to be paid by MESCO, Inc., towards the debt owed to Colonial Bank. The remaining \$500.00 of the monthly payment owed to Colonial would be paid by way of a salary deduction from Ronnie Clayton's salary, which was set at \$72,000.00 per year pursuant to the Agreement.

In September of the year 2000, Defendants Craig and Linda Veach, the Debtors, purchased the assets of MESCO, Inc. for \$1,200,000.00, from Don and Brenda Guthrie. At or about the same time, the Veaches formed a Limited Liability Company which they called MESCO, L.L.C. As a result of the transaction between the Veaches and the Guthries, all, or substantially all, of the assets of MESCO, Inc., became the assets of MESCO, L.L.C. It is important to bear in mind that MESCO, Inc. is a separate entity from MESCO, L.L.C.

MESCO, Inc., was a corporation which was in the business of repairing commercial ovens and refrigerators. MESCO, Inc., was a going concern business which had employees, customers and assets. When the Guthries and the Veaches caused the transfer of these valuable assets out of MESCO, Inc. to MESCO, L.L.C. they perpetrated a fraud upon the Claytons. Prior to the time of the Veach-Guthrie transaction in September 2000, the Claytons owned 12% of a corporation with assets, employees and a going concern business. Immediately after the Veach-Guthrie transaction, the Claytons owned 12% of nothing. Hence the fraud.

At or about the time of the Veach-Guthrie transaction, whereby the assets of MESCO, Inc., became the assets of MESCO, L.L.C., a separate agreement was entered into, entitled "Agreement to Assume Obligation." Plaintiffs' Exhibit 3. This agreement was executed on September 27, 2000 by Craig Veach and Brenda Guthrie and provides as follows:

1. MESCO, LLC will assume the agreement dated February 21st, 2000 between Ronnie Clayton and MESCO, Inc.
2. Said Debt ¹ shall be promptly paid to Colonial Bank, Note [account number omitted], as follows: Ronnie Clayton is to pay \$500.00 per month toward the debt in the form of salary reduction and MESCO, LLC will pay \$1,500.00 monthly or the balance of the actual monthly payment which is \$1,911.52 until the debt is paid in full.
3. MESCO, LLC will honor the stock when and if it is ever addressed by Mr. Ronnie Clayton. This Agreement shall be governed under the laws of the state of Alabama and shall be binding upon and inure to the benefit of the parties, their successors, assigns, and personal representatives.

Plaintiffs' Exhibit 3.

After the transfer of the assets to MESCO L.L.C., Don Guthrie continued to have a role in the business affairs of MESCO, L.L.C., notwithstanding the fact that it did not appear that he owned an interest in the new entity. Ronald Clayton testified that his employment at MESCO, L.L.C. was terminated at a meeting chaired by Don Guthrie, with Craig Veach present. Craig Veach testified that Clayton was terminated because he had taken action which was detrimental to MESCO. The precise nature of the detrimental action was not specified.

¹ This appears to be a reference to the \$150,000.00 which the Claytons borrowed from Colonial Bank.

The Court heard the testimony of the witnesses, and has considered the exhibits submitted and the argument made by counsel both in Court at the October 27, 2003 hearing and in the written submissions of the parties, and finds that Don Guthrie and Craig Veach together perpetrated a fraud on Ronald and Lisa Clayton. By transferring the assets of the corporation to the limited liability company, Guthrie and Veach together perpetrated the fraud. The subsequent termination of Ronald Clayton's employment with MESCO, L.L.C. was a mere pretext to avoid MESCO's share of the liability on the Colonial Bank note.

The Veaches argue, in their post-trial submission, that "[t]he evidence clearly showed that the Veaches knew nothing about any prepurchase arrangements the Guthries had made with the Claytons between Colonial Bank and the Claytons." (Doc. 20, p. 3). If that statement were true, then the Veaches would have a valid defense, and any fraud which may have been perpetrated upon the Claytons would be the sole responsibility of the Guthries. However, the Veaches factual assertion is contradicted by the "Agreement to Assume Obligation," dated September 27, 2000, (Plaintiffs' Exhibit 3) wherein the Colonial Bank note, of which the Veaches now say they know nothing, is explicitly mentioned. Craig Veach signed the September 27, 2000 Agreement. The Veaches are not credible and the Court rejects their factual assertions.

If it was the intention of the Veaches and the Guthries to effect a transaction whereby the Veaches would succeed to the Guthries' interest in MESCO, Inc., the most logical and straightforward thing to have done would have been for the Guthries to sell their 88% of the common stock, leaving unaffected Claytons' 12% interest. Rather, the Veach-Guthrie transaction was an asset purchase which was calculated to defraud the Claytons out of their 12% interest.

Ronald Clayton was employed by MESCO, Inc., at the time the February 21, 2000, Agreement was executed. Plaintiffs' Exhibit 1. It was his understanding, from his dealings with Guthrie, that MESCO was a going concern business and that it was contemplated that profits generated by the business would be used to pay, in part, the Colonial Bank note. Clayton reasonably relied upon representations made by Guthrie and later by Veach. Veach was aware of the dealings between Clayton and Guthrie and structured his purchase of the assets with the purpose of defrauding Clayton. Clayton was damaged by his reliance upon the Guthrie-Veach misrepresentations at least to the extent of his investment in MESCO, Inc., as well as his expectation of future profits. Clayton did not invest \$150,000.00 with a view to recoup that amount, but rather with a view to make a profit. As the Claytons propose to return to Circuit Court to litigate their fraud claims, it is not necessary for this Court to liquidate the damages. Moreover, it should be noted that the Guthries are not parties to this Adversary Proceeding, while they are parties to the civil action in Circuit Court.² Because the Circuit Court will have a better overall view of the matter, it is appropriate that the Circuit Court make a determination as to damages.

In this Adversary Proceeding, the Plaintiffs are seeking a determination that the subject indebtedness is excepted from discharge with respect to both Craig Veach and Linda Veach. Craig Veach had been a banker for 12 years and was in control of MESCO, L.L.C. It is clear that he knowingly took actions which resulted in the fraud perpetrated on the Claytons. Linda Veach appeared to have less control over the relevant machinations, which raises a question about whether her

²As discussed infra, it appears that the Claytons settled their claims against the Guthries in the state court proceeding. See Doc. 21.

involvement was sufficient to except her liability from discharge. The Court heard the testimony of the witnesses and had the opportunity to observe the demeanor of the parties and the dynamics of this situation. While the question of whether Linda Veach is sufficiently culpable so as to cause her liability to be excepted from discharge is a closer question than is the determination with respect to her husband, the Court finds that she acted in concert with her husband and therefore should be charged with liability. The Court notes that Veaches did not argue, in the alternative, that Linda was less culpable than Craig, or that the Court should consider a determination only Craig acted fraudulently. See Doc. 20.

II. ISSUE

This issue here is whether the indebtedness owed by Craig and Linda Veach to Ronald and Lisa Clayton is excepted from discharge pursuant to 11 U.S.C. § 523(a)(2) or (4). For the reasons set forth below, the Court finds that it is excepted from discharge, meaning that the Claytons are free to pursue collection of the indebtedness as if there were no intervening bankruptcy filing.

III. DISCUSSION

This is an adversary proceeding to determine whether an indebtedness is excepted from discharge pursuant to 11 U.S.C. § 523(a)(2) or (4). The Veaches filed a petition in bankruptcy pursuant to Chapter 7 of the Bankruptcy Code on October 11, 2002. (Case No. 02-33243). A meeting of creditors was scheduled for November 15, 2002. (Case No. 02-33243, Doc. 4). Complaints objecting to discharge pursuant to 11 U.S.C. § 727(a) and complaints seeking a determination whether a given indebtedness is excepted from discharge pursuant to 11 U.S.C. § 523(c), must be filed within 60 days of the meeting of creditors. FED. R. BANKR. P. 4004(a) and

4007(c). Thus, the bar date for complaints in this case was January 14, 2003. (Case No. 02-33243, Doc. 4).

Three timely complaints were filed: (1) Porter Capital Corporation v. Veach, Adversary Proceeding 03-3007; (2) Capital One Bank v. Veach, Adversary Proceeding 03-3008, and (3) the instant proceeding, Clayton v. Veach, Adversary Proceeding 03-3009.

The first of these three Adversary Proceedings, Porter Capital Corporation v. Veach, was settled by way of an agreed judgment against the Veaches in the amount of \$75,000.00, which is excepted from discharge pursuant to Section 523(a)(2). The agreed judgment does not mention Porter Capital Corporation's Section 727 claim, therefore that Court finds that this claim was abandoned. While the Veaches owe an indebtedness of \$75,000.00, which will survive their discharge in bankruptcy, the judgment in that Adversary Proceeding will not bar the entry of a general order of discharge. The second Adversary Proceeding, Capital One Bank v. Veach, was recently dismissed.

The complaint in the third of these Adversary Proceedings, the instant matter involving the Claytons, raised only a Section 523(a) claim, but did not make a Section 727(a) claim. The Court notes that at the time the Clayton complaint was filed, their counsel filed an Adversary Proceeding cover sheet with the Section 727 box checked. This seemingly minor error on the part of counsel has delayed entry of the discharge in the Veach bankruptcy. To summarize, the Veaches will be granted a general discharge, pursuant to Section 727, in the near future. This will have the effect of discharging all of their debts, except for the debts owing to the Claytons and to Porter Capital Corporation. Upon entry of judgment in this adversary proceeding, the Claytons are free to pursue their litigation against the Veaches in the Circuit Court of Montgomery County. The indebtedness owed, which is unliquidated at

this time, is excepted from discharge.

This Court has jurisdiction to hear this Adversary Proceeding pursuant to 28 U.S.C. § 1334. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(I). Therefore, this Court may enter a final order.

The complaint filed in this case is cast in terms of 11 U.S.C. § 523(a)(4), which excepts from discharge debts for fraud or defalcation incurred while acting in a fiduciary capacity. Yet, the conduct of the trial and the post-trial submissions are cast in terms of fraud in a more general sense, which implicates Section 523(a)(2)(A). As there has been no mention of a fiduciary capacity, a necessary element of a 523(a)(4) case, the Court will treat this as a proceeding under Section 523(a)(2)(A). The Court finds that the issue has been tried by the implied, if not the express, consent of the parties. See FED. R. CIV. P., 15(a); FED. R. BANKR. P. 7015.

Section 523(a) of the Bankruptcy Code provides, in part, that:

(a) A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt—

* * *

(2) for money, property, services . . . to the extent obtained, by—
(A) false pretenses, a false representation, or actual fraud.

11 U.S.C. § 523(a)(2)(A).

The question becomes, whether a fraud has been committed upon Ronald and Lisa Clayton by Defendants Craig and Linda Veatch. The elements of a case under Section 523(a)(2) are as follows:

- (1) the debtor(s) made a false representation to deceive the creditor(s),
- (2) the creditor relied on the misrepresentation,

(3) the reliance was justified, and

(4) the creditor sustained a loss as a result of the misrepresentation.

Securities and Exchange Commission v. Bilzerian (*In re Bilzerian*), 153 F.3d 1278, 1281 (11th Cir. 1998).

The first element, a false representation to deceive the creditor, may be found in a series of statements made by Craig and Linda Veach and Don Guthrie. Guthrie sold 12% of the stock of MESCO, Inc., to Clayton and later sold all of the assets of MESCO, Inc. to Veach who transferred the assets into an entity known as MESCO, L.L.C. The sale of the assets by Guthrie to Veach/MESCO, L.L.C. was intended to defraud, and did in fact defraud, Clayton. Both Guthrie and Veach made false statements to Clayton, giving him assurance that his interest in the business was protected. These misrepresentations culminated in a document entitled “Agreement to Assume Obligation,” dated September 27, 2000, which was calculated to mislead Clayton. (See Plaintiffs’ Exhibit 3). To put the matter simply, Clayton owned 12% of a going concern business with assets and employees. After the consummation of the Veach-Guthrie transaction, Clayton owned nothing.

The second element, reliance, was established by the testimony of Ronald Clayton. The Court heard Ronald Clayton’s oral testimony and observed his demeanor. The Court finds that Clayton was forthright and credible and gives credence to his testimony. The Court finds that Clayton relied upon the statements made by Veach.

The third element is whether the Plaintiffs’ reliance was justified. The Defendants have not argued to the contrary and the Court finds that, given the facts known by Clayton at the time the statements were made in September of 2000, the Plaintiffs’ reliance was justifiable.

The fourth element is loss. The scheme whereby Guthrie and Veach transferred all of the assets from MESCO, Inc., to MESCO, L.L.C., effectively destroyed the value of Clayton's 12% interest in the corporation. However, Clayton seeks only a determination that the indebtedness owed to him is excepted from discharge pursuant to Section 523(a). Clayton seeks to liquidate his claim in state court. Therefore, it is not necessary for this Court to liquidate the damages, rather it will simply find that Clayton suffered a loss sufficient to give rise to a cause of action sounding in fraud and leave the precise amount to be determined at a later time.

The Defendants recently filed a Motion to Supplement the Record in which they request that this Court take notice of a joint motion to dismiss which has been filed in the civil action in the Montgomery County Circuit Court. (Doc. 21). In that motion, all of the Defendants, except Craig and Linda Veach are to be dismissed. The Court does not have any more information than this, however, it would appear that the Claytons have settled with other joint tortfeasors and seek to litigate their claims against the Veaches. That joint motion to dismiss does not have any bearing on the instant proceeding. To be sure, a pro tanto settlement may have an effect upon the ultimate liability owed by Veaches. The Veaches may plead that in the context of the suit in Circuit Court, but it has no impact upon these proceedings. For this reason, the motion is DENIED.

The Veaches also filed a Motion to Join Indispensable Party. (Doc. 18). As this Adversary Proceeding is one to determine whether the debt owed by the Veaches to the Claytons is excepted from discharge, it would not be appropriate to join additional parties to this Adversary Proceeding. It appears that these "indispensable parties" were in fact joined to the proceeding in Montgomery County Circuit Court and later dismissed, presumably as a result of a settlement. This motion is not well taken

and is likewise DENIED.

For the reasons set forth above, the Court determines that the indebtedness owed by the Veaches to the Claytons is excepted from discharge pursuant to 11 U.S.C. § 523(a)(2). The Court will enter judgment by way of a separate document.

Done this 20th day of February, 2004.

/s/ William R. Sawyer
United States Bankruptcy Judge

c: Michael G. Strickland, Attorney for Plaintiffs
Hugh V. Smith, Jr., Attorney for Defendants